The Pakistan Credit Rating Agency Limited

NATIONAL BANK OF PAKISTAN (NBP)

ENTITY RATINGS REPORT

	NEW [DEC-17]	PREVIOUS [JUNE-17]
Entity		
Long Term	AAA	AAA
Short Term	A1+	A1+
Outlook	Stable	Stable

REPORT CONTENTS

1. RATING ANALYSES
2. FINANCIAL INFORMATION
3. RATING SCALE
4. REGULATORY AND SUPPLEMENTARY DISCLOSURE

DECEMBER 2017

Profile & Ownership

- National Bank Limited (NBP), incorporated in 1949, under National Bank of Pakistan Ordinance, is second largest commercial bank – system share: ~13%
- Operates with a network of over 1,494 branches including 150 Islamic branches across the country
- One of the largest overseas network amongst local banks
- Government of Pakistan (GoP), through SBP, holds controlling stake (~76%), followed by Financial Institutions (20%),

Governance & Management

- GoP nominated seven-member board of directors including the President & CEO; one executive, five non-executive and one independent director
- With directors nominated by the GoP, the risk of political intervention remains
- Mr. Saeed Ahmad assumed the seat of President and CEO from outgoing head Mr. Syed Ahmed Iqbal Ashraf in Mar-17
- The President is a seasoned banker having over three decades of experience of domestic and international markets

Risk Management

- During end-Sep17, the bank witnessed decent growth in advances portfolio (up 8% YoY), however, on the other hand, deposits registered impressive growth of 19% as well, outpacing the industry
- ADR remaining stagnant at last year's level of 40% at end-Sep17, below industry average
- Top-20 performing clients' concentration stood at 10%; considered good
- In line with historical trend, NBP's asset quality (16%) declined during 9MCY17; considered weak as compared to peer banks
- Total delinquencies increased, as NPLs stood at (end-Sep17: PKR 129bln, end-Sep16: PKR 106bln); requiring management's attention
- Mix of government securities in overall investments increased to 93%, (end-Sep16: 91%)

Performance

- Asset yield decreased from 7.8% to 6.3% YoY in 9MCY17 – due to maturity of high yielding PIBs, cost of funds further rationalized to 3.8% (9MCY16: 4.4%); still higher than AAA rated banks
- Spreads recorded a decline of 100bps and stood at 2.4% at end-Sep17
- As the spreads were squeezed, the bank registered decline in its NIMR of 2%
- Contribution from non- markup income improved during 9MCY17 by 10% – a factor of higher fee income
- Cost to total net revenue shot up to 63% in 9MCY17 (9MCY16: 60%), highest amongst peer banks
- Bank was able to achieve growth in profitability of 10% also getting support of reversal in provisioning expense
- Unrealized gains on government securities stood at PKR 1.8bln at end-Sep17
- Going forward, NBP's key focus would be to enhance its lending book mainly through infrastructure lending; though it remains a challenge. Asset quality remains a challenge; needs management attention.
- As the government has announced all time high PSDP, the bank is set to take the most benefit of the developmental budget

Funding & Capital

- Customer deposits with 76% contribution remained the key source of funding for the bank. CASA mix improved to 74%; lower than other large banks
- Meanwhile, top-20 deposits concentration slightly inched up to 16% at end-CY16 (end-CY15: 15%)
- Overall liquidity position remained strong on account of relatively high growth in govt. securities as against deposits and borrowings
- CAR has declined during the year (end-Sep17: 14.8%) and predominantly comprises Tier-I capital (end-Sep17: 10.6%)

RATING RATIONALE

The ratings are driven by strong ownership structure (Government of Pakistan (GoP) holds majority stake). The bank's strong financial risk profile, characterized by firm risk absorption capacity, provides strength to the ratings. NBP's renowned franchise along with extended outreach aids the bank in deposit mobilization; public-private deposit mix remained intact. During CY16, the bank's deposit growth outpaced the industry. This helped in fortifying NBP's system share in the country's deposits. Time deposits have a high proportion in NBP's deposit; hence its funding cost reflects room for improvement. Bank withstood pressure on NIMR in 2016, though with PIBs maturity, this was inevitable. High cost structure of the bank is limiting profitability. As against historical trend, NBP's asset quality improved during CY16, though it is still considered weak as compared to peer banks. Overseas operations and domestic private credit are key contributors to overall infection. Thus strengthening of related risk management systems is important. Going forward, the bank is keen to strengthen its lending portfolio; entering into profitable avenues seems a challenge. With focused efforts, NBP has managed to bring volumes in Islamic banking (Aitemaad) though limited; it is targeted to contribute towards growth.

KEY RATING DRIVERS

The ratings are dependent upon the management's ability maintain relative standing of the bank in the industry in all key parameters. The Senate passed Depositor Protection Act in 2016. Accordingly, Depositor Protection Corporation (DPC) would be established as a wholly owned subsidiary of SBP. This is to provide protection to small depositors and maintain trust in financial system. Once implemented, protection available to NBP depositors under the Banks (Nationalization) Act, 1974 (clause 4 of section 5) would be removed.

INDUSTRY SNAPSHOT

The banking sector experienced substantial expansion in its deposit base (2016: 14%). Building on the uptick in the economy, advances also grew by a sizeable margin after a lag of many years. Given GDP growth in FY17 and other macro-economic fundamentals, credit expansion is foreseen. Hence, CAR is going to be a challenge, as profits would also suffer due to PIBs maturities.

National Bank of Pakistan (NBP)

PKR mln

BALANCE SHEET	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
	9M	Annual	Annual	Annual
Earning Assets				
Advances (Net of NPL)	668,535	662,060	564,572	607,223
Debt Instruments	62,492	56,275	20,204	7,519
Total Finances	731,027	718,335	584,776	614,742
Investments	1,164,391	850,742	806,287	551,294
Others	31,500	134,459	24,266	129,703
	1,926,918	**1,703,536**	**1,415,328**	**1,295,738**
Non Earning Assets				
Non-Earning Cash	169,425	160,915	154,457	92,165
Deferred Tax	4,578	5,136	9,669	9,878
Net Non-Performing Finances	3,755	(4,557)	16,306	22,433
Fixed Assets & Others	119,396	110,676	110,601	122,840
	297,153	**272,170**	**291,033**	**247,316**
TOTAL ASSETS	**2,224,071**	**1,975,706**	**1,706,361**	**1,543,054**
Interest Bearing Liabilities				
Deposits	1,684,805	1,657,312	1,431,037	1,233,525
Borrowings	259,879	44,890	21,947	37,554
	1,944,684	1,702,202	1,452,984	1,271,080
Non Interest Bearing Liabilities	105,833	96,771	85,026	93,646
TOTAL LIABILITIES	**2,050,517**	**1,798,973**	**1,538,010**	**1,364,725**
EQUITY (including revaluation surplus)	**173,554**	**176,733**	**168,351**	**178,329**
Total Liabilities & Equity	**2,224,071**	**1,975,706**	**1,706,361**	**1,543,054**

INCOME STATEMENT	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
Interest / Mark up Earned	87,816	114,403	113,662	114,174
Interest / Mark up Expensed	(49,508)	(59,578)	(59,941)	(70,007)
Net Interest / Markup revenue	**38,308**	**54,824**	**53,721**	**44,166**
Other Income	22,987	29,967	34,983	31,472
Total Revenue	**61,294**	**84,791**	**88,704**	**75,639**
Non-Interest / Non-Mark up Expensed	(38,048)	(48,351)	(43,667)	(42,561)
Pre-provision operating profit	23,246	36,440	45,037	33,078
Provisions	(24)	701	(11,821)	(11,077)
Pre-tax profit	23,222	37,141	33,216	22,001
Taxes	(8,517)	(14,389)	(13,997)	(6,973)
Net Income	**14,705**	**22,752**	**19,219**	**15,028**

Ratio Analysis	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
Performance				
ROE	17%	19%	17%	14%
Cost-to-Total Net Revenue	63%	58%	50%	59%
Provision Expense / Pre Provision Profit	0%	-2%	26%	33%
Capital Adequacy				
Equity/Total Assets	5%	6%	7%	7%
Capital Adequacy Ratio as per SBP	15%	17%	18%	17%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	70%	67%	67%	59%
Advances / Deposits	40%	40%	40%	51%
CASA deposits / Total Customer Deposits	74%	69%	73%	73%
Intermediation Efficiency				
Asset Yield	6%	8%	9%	10%
Cost of Funds	4%	4%	5%	7%
Spread	2%	3%	4%	3%
Outreach				
Branches	1,494	1,448	1,403	1,377

CREDIT RATING
SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

LONG TERM RATINGS

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

SHORT TERM RATINGS

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information